Chapter 4

International Resource Movements

International Resource Movements

- Issues studied
  - What are the main productive forces?
  - What are the main causes of international resource movement?
  - What are the effects of the international resource movement?
  - Who conducts the international resource movement? (the main players?)

Foreign Investment

- Definition
  - Investment: to use certain assets (capital, technology, land...) into concrete economic activity to create one or more products for the society in order to earn profit
  - International investment: movements of the assets (capital, technology, management skill...) from one country to another in order to run business to earn high profit in the global scale

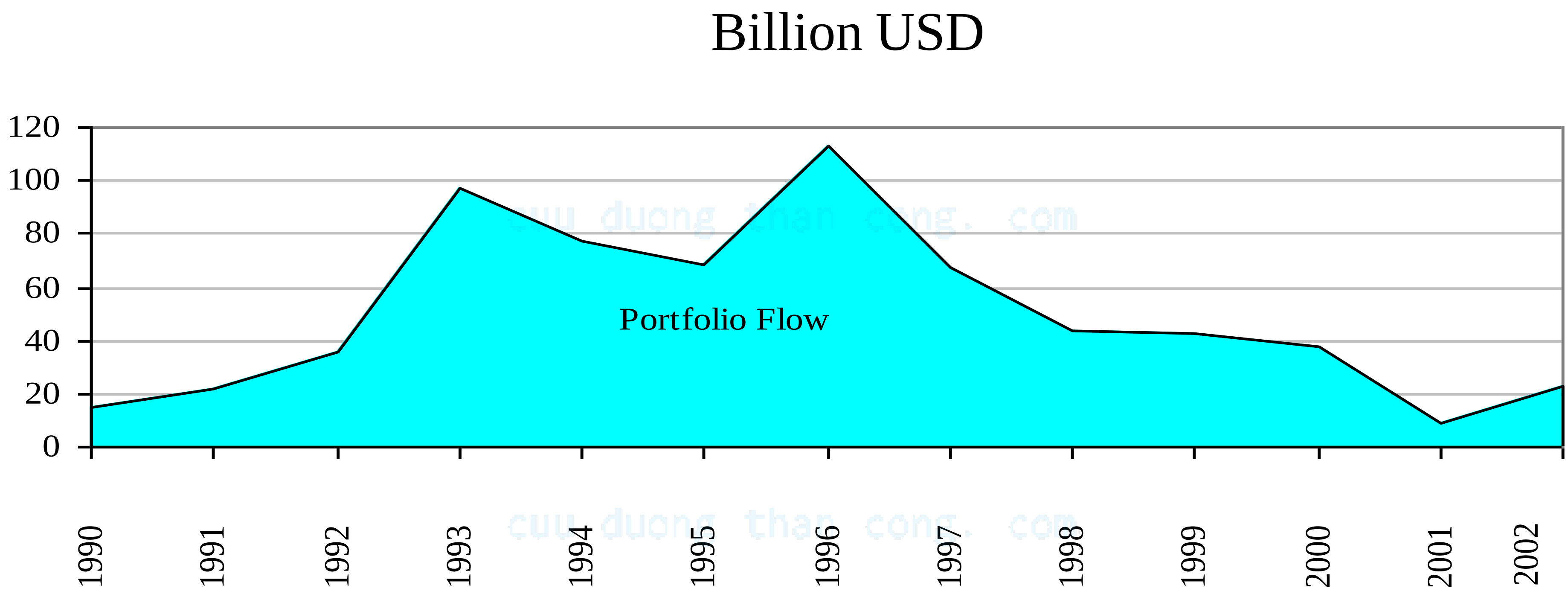
Foreign Investment

- Characteristics of Investment
  - Profitability
  - Risk
- Differences of Foreign I. & Domestic In.:
  - Owner: foreigners (nationality, language…)
  - Capital moves across the national boundary (policy, legal system, custom, transportation…)
  - Foreign exchanges are involved (ER)

Foreign Investment

- Forms of Investment
  - Portfolio I (financial investment): financial assets (bonds, stocks), denominated in a national currency; not involve in management; short term;
  - Direct I: real investment in factories, capital goods, land and inventories where both capital and management are involved and the investors retains control over use of invested capital; medium &long term

Some data on International Capital Flows (FPI)



FPI motives: to earn higher returns abroad
FPI: Risk diversification

Return (%)	Stock A	Stock B
Lowest	20	10
Highest	40	50
Average Rate	30	30

➔ Stock B is riskier than stock A.

➔ If changes in yields are inversely correlated overtime => holding both stocks can give the yield of 30% of average to investor with lower risk.

What is FDI?

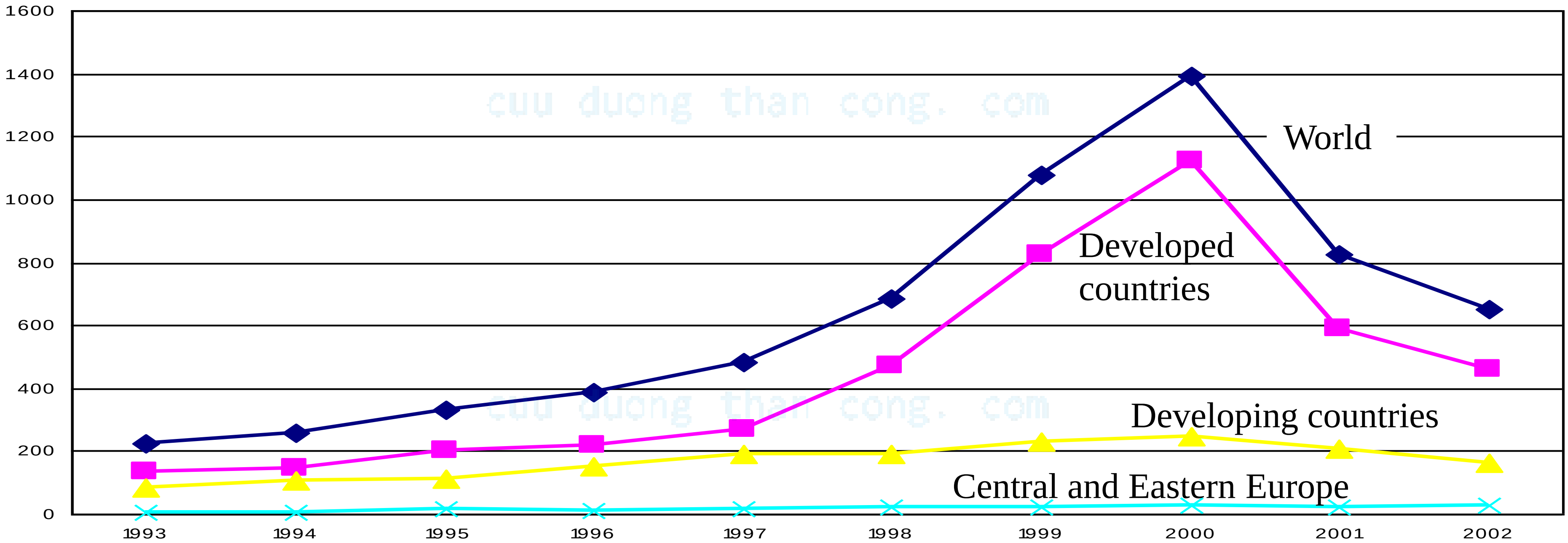
FDI occurs when a firm invests directly in facilities to produce and/or market a product in a foreign country.

Ownership: 10% (*Foreign Direct Investment, IFC 1997, p.9)*

- A company buying a firm in a different country.
- A firm creating a 'Greenfield' operation in a different country
- A firm creating a subsidiary in a different country.
- Also:
  - The firm has significant control of its foreign operation.
  - Firm can affect managerial decisions of the foreign operation.

Some data on International Capital Flows (FDI)

- FDI flow



Flow vs Stock of FDI

- *Flow*: Amount of FDI over a period of time (one year).
- *Stock*: Total accumulated value of foreign owned assets at a given point in time.

FDI Growth in the World Economy

- *FDI Outflow* of $25 billion in 1975 increased to $1.4 trillion in 2000 and $2.099 trillion in 2007
- FDI flow accelerated more than world trade and world output
- *FDI Flow* from all countries increased 1000%, trade 91%, world output 27% from 1984 to 1998
- *FDI Stock* increased from $3.5 trillion by 1997 to $15 trillion by 2007
- 79,000 parent firms with 790,000 foreign affiliates produced $31trillion sales, almost twice global exports, employees 82 millions
- FDI growing faster than world trade
  - Political risk issues
  - Economic reason issues
  - Globalization

Direction and Source of FDI

- Historically?, FDI flow was to developed countries from other developed countries ($1,444/2,099 billions inflow & $1,923/2,267 billions outflow in 2007)
  - Much of this to the US 1st, UK 2nd, France 3rd (EU: 2/3 of Devd.con)
- Since 1985 there has been an increase of FDI towards developing countries. 2007 = $564 billions inflow

  - Much to the emerging Asian and Latin America economies
  - Africa lagging

  * Developing countries: source of FDI, 2007 outflow = $ 293 billions
- South-Eastern Europe and CIS: $ 90.9 billions inflow & $51.5 billions outflow

- Though 1970s US led in FDI outflows
  - 1985-1990 Japan 1st, UK 2nd, US 3rd
  - Effect of ¥ increase in value

(world FDI inflows 2008: $1,770 billions and 2009: $ 1,114 billions)

Forms of FDI

- FDI forms
  - Purchase of existing assets
    - Quick entry, local market know-how, local financing may be possible, eliminate competitor, buying problems
  - New investment
    - No local entity exists or is available for sale, local financial incentives may encourage, no inherited problems, long lead time to generation of sales or other desired outcome
  - Participation in an international joint-venture
    - Shared ownership with local and/or other non-local partner

Forms of FDI

- Horizontal Direct Investment
- Vertical Direct Investment

Horizontal Direct Investment

- FDI in the same industry abroad as company operates at home.

HDI, When and Why?

- Transportation too costly?
- Most cited: Market Imperfections (Internalization Theory)
  - Impediments to the free flow of products between nations.
  - Impediments to the sale of know-how.
- Follow the lead of a competitor - strategic rivalry.
- Product Life Cycle - however, does not explain when it's profitable to invest abroad.
- Location specific advantages (natural resources).

Vertical Direct Investment

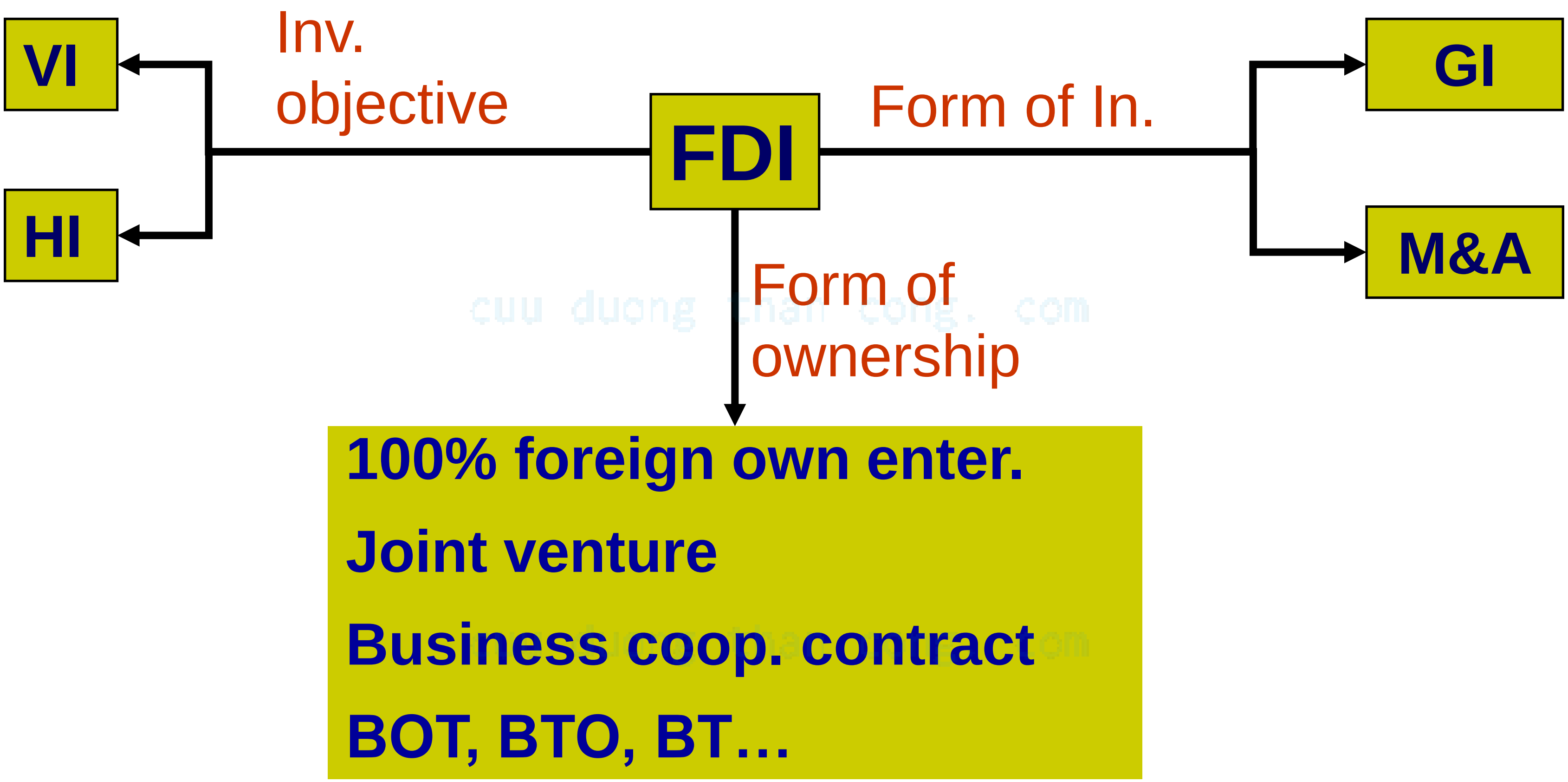
- *Backward* - investments into industry that provides inputs into a firm’s domestic production (typically extractive industries).
- *Forward* - investment in an industry that utilizes the outputs from a firm’s domestic production (typically sales and distribution).
- => International specialization of production

VDI, When and Why?

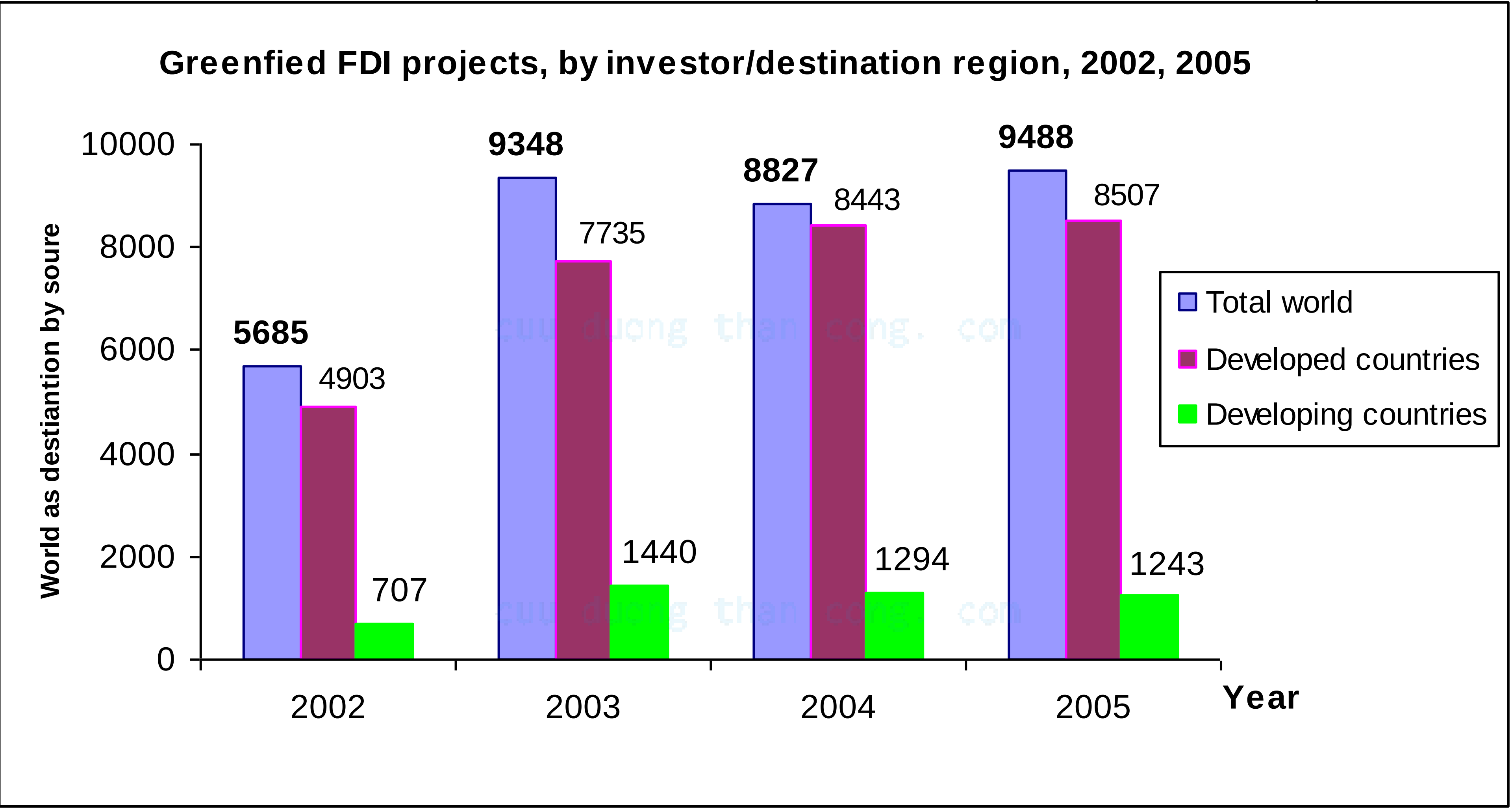
- Market power?
  - create entry barriers.
  - erode entry barriers.

- Market imperfections
  - Impediments to the sale of know-how.
  - Investments in specialized assets.

FORM OF FDI


VI
HI
Inv. objective
FDI
Form of In.
GI
M&A
Form of ownership
100% foreign own enter.
Joint venture
Business coop. contract
BOT, BTO, BT…

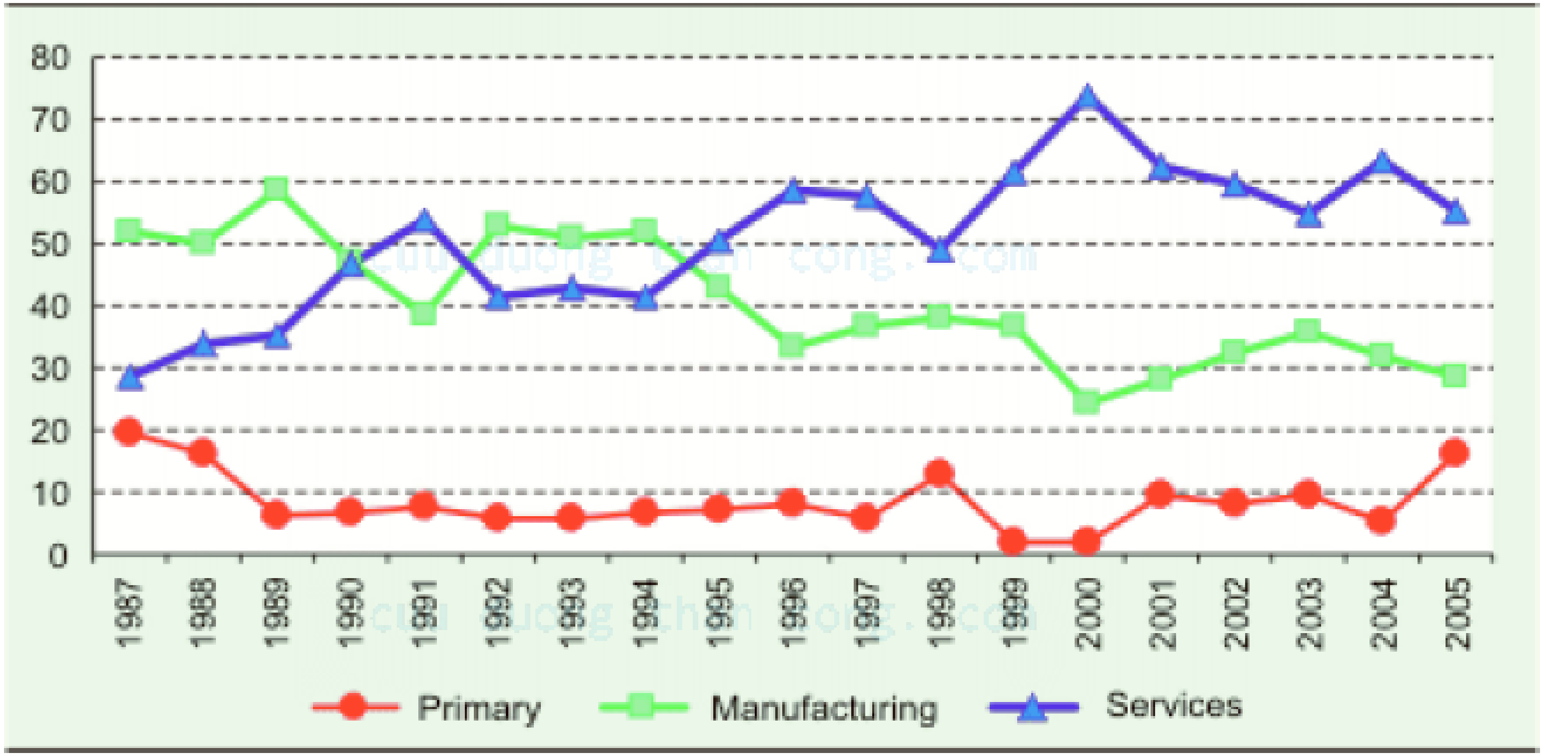
Greenfield FDI



Merger and Acquisition

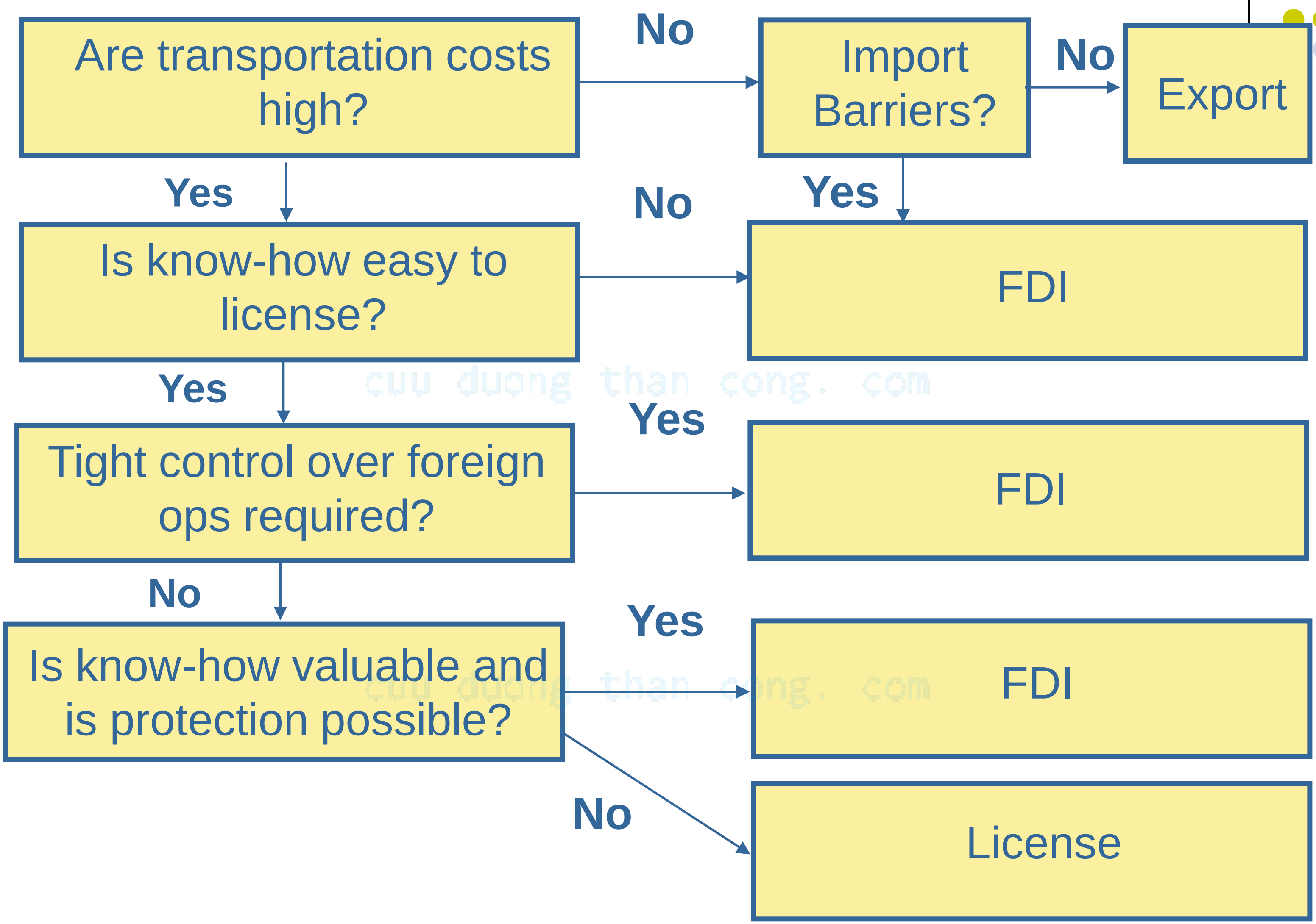
Figure I.5. Sectoral breakdown of cross-border M&A sales, 1987-2005

(Per cent)



Source: UNCTAD, based on its FDI/TNC database (www.unctad.org/fdi statistics).

Decision Framework for FDI



Welfare effect of int cap flows

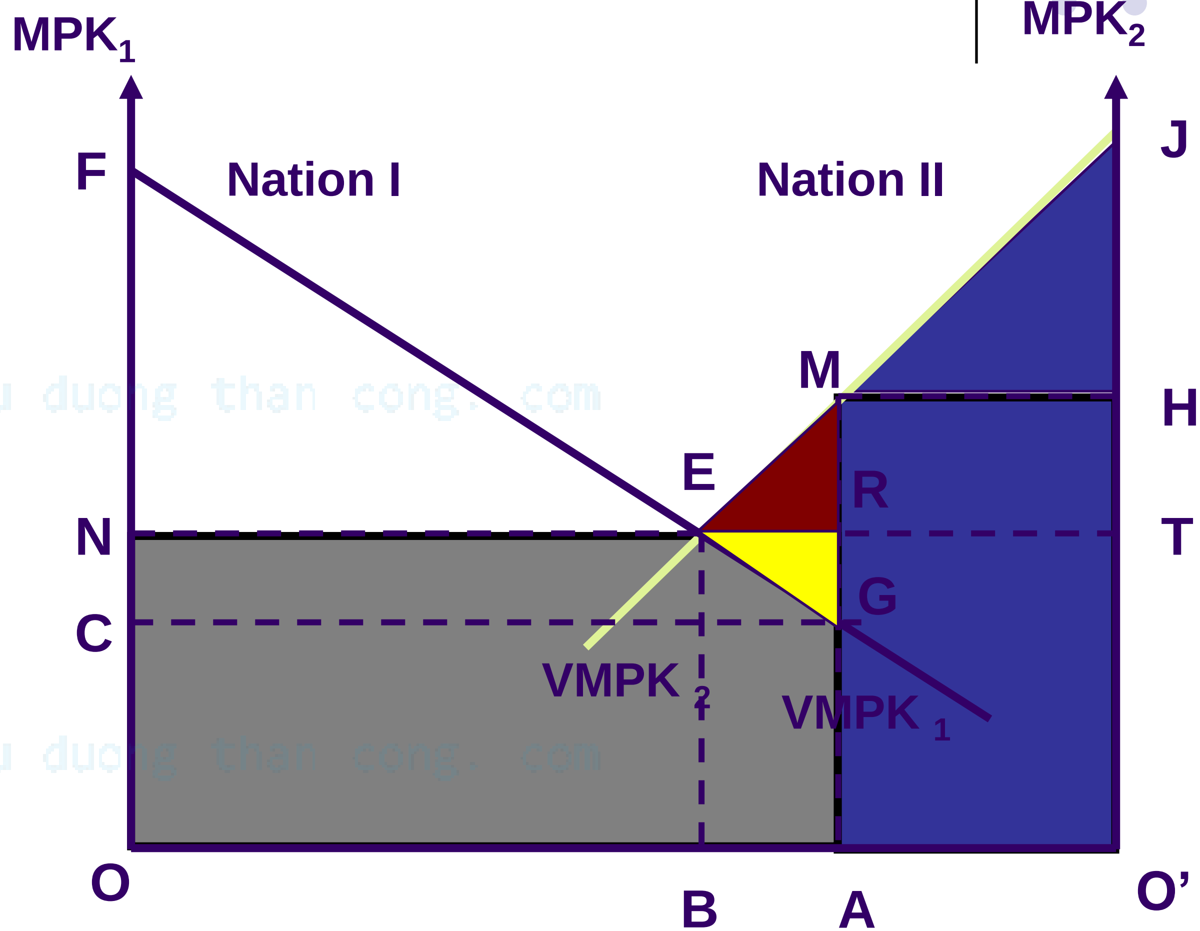
Before capital movement

Nation I

- -Total cap stock: OA
- - Int rate: OC
- - Total output: OFGA
  - - Capital owners: OCGA
  - - Other owners: CFG

Nation II

- -Total cap stock : O'A
- - Int rate: O'H
- - Total output: O'JMA
  - - Capital owners: O'HMA
  - - Other owners: HJM

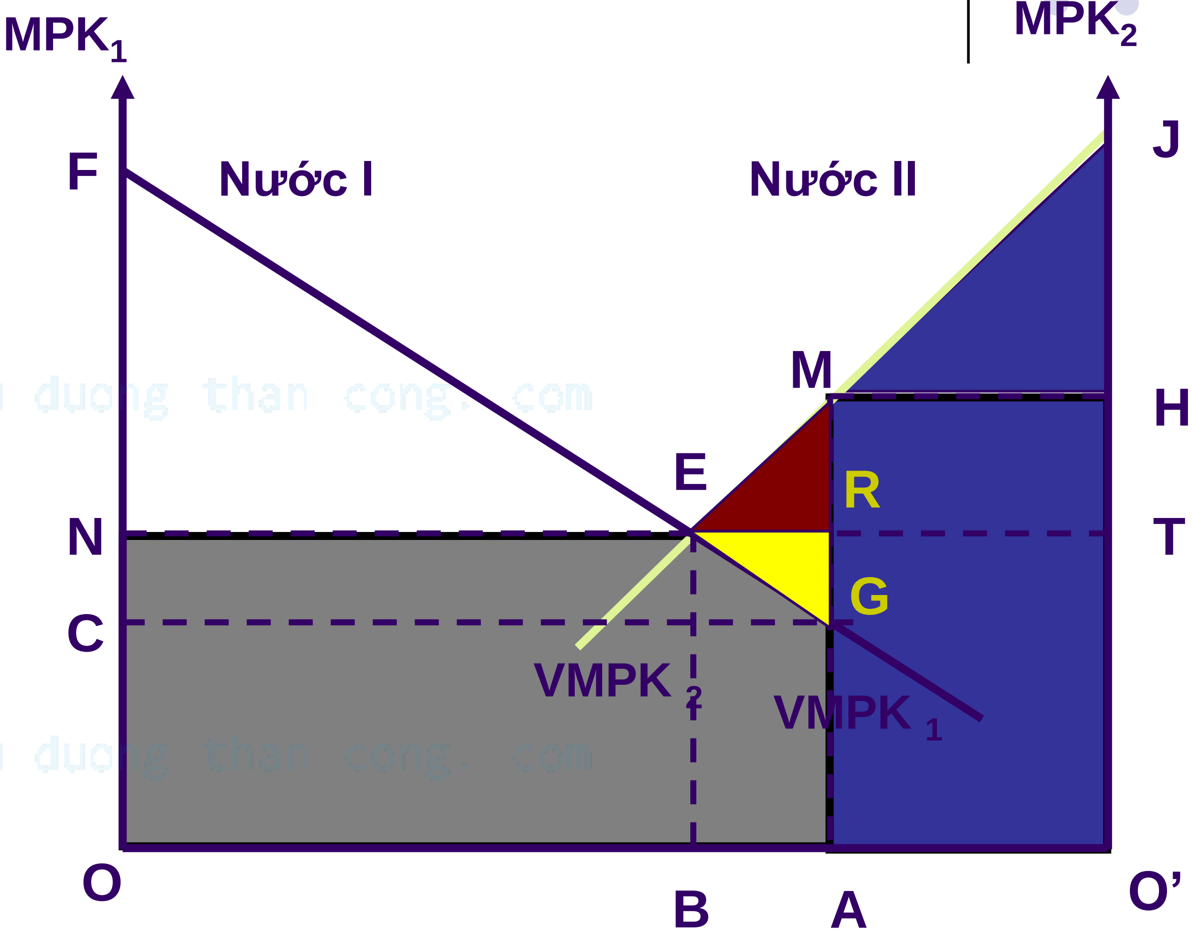


O'H > OC ➔ part of capital of Nation I (AB) moves to Nation 2 until interest rate is equal between two nations BE (ON=O'T).

Welfare effects of cap. Mov. on investing Nation (N1- home country)

With the capital movement

- **Total capital stock: OA**
  - **AB is investing abroad**
- **Int rate: ON**
- **Total output: OFERA**
  - **domestic output: OFEB**
  - **Return on investment: ABER**



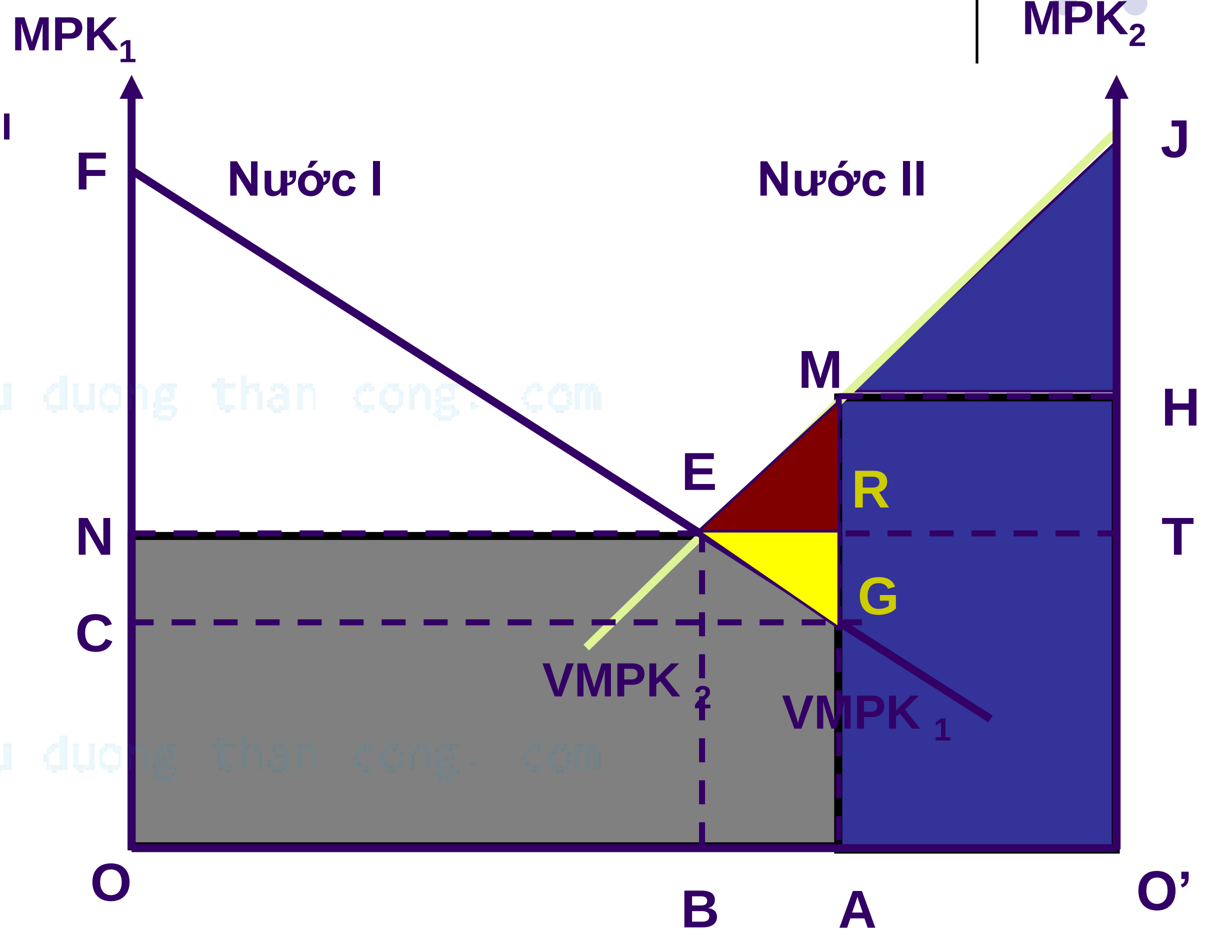
Compare with before cap mov

- **Increase in output: ERG**
  - **Gain of cap owners: CNRG**
  - **Loss of other: CNEG**

Welfare effects of cap.mov. receiving Nation (N2- host country)

With the cap mov

- Total capital stock : O'B
  - -AB is investment from Nation I
- Int rate: O'T
- Total output: O'JEB
  - repartriation to N I: ABER
  - Remaining: O'JERA



Compare with before cap mov

- Increase in output: ERM
  - loss of cap owners: THMR
  - Gain of other: THME

➔ global output icrease: EGM

Multinational Corporations

- **Mutinational Corporations** (MNCs) is one of the most significant international economic developments of the post war period

- This part of chapter examines the reasons for the existence of MNCs and some of the problems they create for the home and the host countries

MNC **Definition**

- Wikipedia: A multinational corporation (MNC) or transnational corporation (TNC), also called multinational enterprise (MNE)[1], is a corporation or enterprise that manages production or delivers services in more than one country. It can also be referred to as an *international corporation*.
- Oil and Gas Field Glossary:
  Multi-National Company: A company with investments and operating activities in many countries around the world.
- MNC: corporations have offices, branches or manufacturing plants in different countries than where their original and main headquarter is located. Having multiple operation points that all respond to one headquarter.

MNC's History

The earlest transnational corporations: the British East India Company (1600) and Dutch East India Company (1602)

http://money.cnn.com/magazines/fortune/global500/2009/snapshots/6388.html

http://money.cnn.com/video/technology/2009/11/11/tt_hp_3com_acquisition.fortune/

- The expanded East India House, Leadenhall Street, London, as rebuilt 1799-1800, Richard Jupp, architect (as seen c. 1817; demolished in 1929)

- The shipyard of the Dutch East India Company in Amsterdam, circa 1750

Hudson's Bay Company
Compagnie de la Baie d'Hudson

- **Type** Private
- **Founded** May 2, 1670
- **Headquarters** Simpson Tower
  Toronto, Ontario, Canada

HUDSON'S BAY CO.

- The Hudson's Bay Company building in Montreal

Theory of Multinational Corporations

- Why are multinational corporations created and why do they undertake direct foreign investment?
- We rephrase these questions into those dealing with

1. **Location**: why is a good produced in two countries rather than in one country and then exported to the second country?
2. **Internalization**: why is production in different locations done by one firm rather that by separate firms?

Theory of Multinational Corporations

- Why production occurs in separate location is often determined by
  - the location of necessary factors of production:
    - mining occurs where minerals are;
    - labor intensive production occurs where relatively large pools of labor live.
  - transportation costs and other barriers to trade may also influence the location of production.
  - These factors also influence the pattern of trade.

Theory of Multinational Corporations (cont.)

- Internalization occurs because it is more profitable to conduct transactions and production within a single organization than in separate organizations. Reasons for this include:

1. **Technology transfers**: transfer of knowledge or another form of technology may be easier within a single organization than through a market transaction between separate organizations.
   - Patent or property rights may be weak or non-existent.
   - Knowledge may not be easily packaged and sold.

Theory of Multinational Corporations (cont.)

2. **Vertical integration** involves consolidation of different stages of a production process.

- Vertical integration would involve consolidation of one firm that produces a good that is used as an input for another firm.
- This may be more efficient than having production operated by separate firms.
- For example, having farms and flour mills consolidate into one organization to make flour may be more efficient that have farms and flour mills as separate organizations.

Multinational Corporations in the US (cont.)

TABLE 7-1 Employment by Foreign-Owned Firms in the United States

	As Percent of Total Nonfarm Employment	As Percent of Manufacturing Employment
1977	1.5	3.8
2002	4.2	14.6

Source: U.S. Commerce Department.